86 - 1340

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

GILBERT R. RUSSELL and CRINCO INVESTMENTS, INC.,

Petitioners,

v.

SHEARSON LEHMAN BROTHERS, INC., formerly known as SHEARSON/LEHMAN AMERICAN EXPRESS, INC., and LEON BOMAR III,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Question Presented

Whether pre-dispute agreements to arbitrate civil claims arising under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* (1982) ("RICO"), are enforceable under the United States Arbitration Act, 9 U.S.C. § 1, *et seq.* (1982)?

Rule 28.1 List

Subsidiaries of Crinco Investments, Inc.:

Arrow Building Corp.

C & R Distributing, Inc.

El Paso Tire Center, Inc.

El Paso Truck Terminal, Inc.

Jordinns of America, Inc.

Petro, Inc.

TABLE OF CONTENTS

Table of Authorities

Cases: PAGE

No. .....

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners Gilbert R. Russell and Crinco Investments, Inc., plaintiffs below, respectfully request that

(a) a writ of certiorari issue to review that part of the judgment of the United States Court of Appeals for the Fifth Circuit, entered on November 13, 1986, which affirmed in part an order of the United States District Court for the Northern District of Texas (Dallas Division) granting the respondents' motion to arbitrate petitioners' RICO claims;

(b) upon issuance of a writ of certiorari, that consideration of that part of the judgment of the Fifth Circuit granting respondents' motion to arbitrate petitioners' RICO claims be withheld pending the issuance of this Court's opinion in *Shearson/American Express, Inc.* v.

McMahon, cert. granted, —— U.S. ——, 107 S. Ct. 60 (U.S. Oct. 6, 1986) (No. 86-44) ("*McMahon*"); and

(c) to the extent that the arbitrability of civil RICO claims is not resolved by this Court's decision in *McMahon*, that this Court decide this issue.

The district court granted the respondents' motion to arbitrate petitioners' claims and, on appeal, the Fifth Circuit affirmed the district court in part and ruled, *inter alia*, that pre-dispute agreements to arbitrate RICO claims are enforceable.

Opinions Below

The opinion of the Court of Appeals for the Fifth Circuit is reproduced at Appendix B hereto. The order of the United States District Court for the Northern District of Texas (Dallas Division) is reproduced at Appendix C hereto.

Jurisdiction

The judgment of the court of appeals was entered on November 13, 1986. A copy of the judgment is reproduced at Appendix D hereto. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Statutory Provisions Involved[1]

The relevant statutory provisions are:

United States Arbitration Act, Section 2, 9 U.S.C. § 2 (1982).

Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961, *et seq.*

[1] The text of these provisions is reproduced at Appendix A.

Statement of the Case

Statement of Facts

From November, 1982 through May of 1984, Petitioners Gilbert R. Russell and Crinco Investments, Inc. each maintained separate securities accounts and commodities accounts at the Fort Worth, Texas office of Respondent Shearson Lehman Brothers, Inc. ("Shearson"). There were four (4) separate accounts.

Waylon Max Nimmo, Shearson's registered representative and a defendant in the district court below, induced the petitioners to open the accounts and transfer their shares of OKC stock from another brokerage firm to Shearson. That was done on the basis of specific representations that such OKC stock would not be utilized to margin transactions in the petitioners' commodities accounts nor would it be liquidated to margin transactions in petitioners' securities accounts except upon prior notice to the petitioners and upon their failure to maintain the required margin after petitioners' receipt of said notice.

Beginning in or about December of 1983 and continuing through May of 1984, in connection with the petitioners' securities and commodities accounts, Nimmo and Respondent Leon Bomar III, the branch manager of Shearson's Fort Worth office, engaged in a scheme to defraud the petitioners by knowingly and intentionally:

(a) trading in petitioners' commodities accounts without authorization;

(b) withholding confirmation of transactions in the petitioners' commodities and securities accounts;

(c) selling petitioners' collateral stock without prior notice to or consent of the petitioners;

(d) concealing the sale of petitioners' collateral stock;

(e) misrepresenting the equity of, and positions in, petitioners' securities accounts;

(f) causing funds to be transferred from the petitioners' securities accounts to the petitioners' commodities accounts to conceal losses caused by the unauthorized trading; and

(g) churning and otherwise manipulating petitioners' accounts.

As a direct consequence of the foregoing, petitioners sustained combined losses in their securities and commodities accounts in excess of $4,000,000.00.

Course of Proceedings

On November 22, 1985 Petitioners Gilbert R. Russell and Crinco Investments, Inc. filed suit in the United States District Court for the Northern District of Texas (Dallas Division) against Respondents Shearson Lehman Brothers, Inc., Leon Bomar III and Defendant Waylon Max Nimmo alleging violations of the Securities Act of 1933, 15 U.S.C. § 77a, *et seq.* ("1933 Act") (Count I); the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.* ("1934 Exchange Act") (Count II); the Commodity Exchange Act, 7 U.S.C. § 1, *et seq.* (Counts IV, V and VI); the Racketeer Influenced and Corrupt Organizations Act (Count III); and various Texas state law (Counts IX, X, XI) and common law claims (Counts VII, VIII and XII).

On January 14, 1986, the respondents moved to dismiss various counts, to compel arbitration of petitioners' remaining claims and to stay all district court proceedings pending the outcome of arbitration.

On March 10, 1986, the district court issued an order which dismissed Counts I and IX of the complaint, quashed

petitioners' outstanding discovery requests, stayed all judicial proceedings and referred all of petitioners' remaining claims to arbitration. Petitioners appealed this order pursuant to 28 U.S.C. § 1292(a)(1) and, on November 13, 1986, the Court of Appeals for the Fifth Circuit reversed the district court with respect to the dismissal of petitioners' claims under the 1933 Act; reversed the district court with respect to the requirement that petitioners' claims under the 1934 Exchange Act be arbitrated; vacated the district court's stay of judicial proceedings as to the petitioners' 1933 Act and 1934 Exchange Act claims; and affirmed the district court's order requiring the petitioners to arbitrate their RICO and Commodity Exchange Act claims. *See* Appendix B at A-12.

Reasons for Granting the Writ

The decision by the Court of Appeals for the Fifth Circuit compelling the arbitration of petitioners' RICO claims is in direct conflict with the decisions of the Courts of Appeals for the First, Second and Eleventh Circuits.[2]

Moreover, implicit in the congressional scheme to afford an express private statutory remedy under RICO to recompense persons and businesses injured by a pattern of racketeering activity are overwhelming public policy considerations unsuitable for unscrutinized determination by arbitrators. Petitioners respectfully submit that their claims arising under the express civil provisions of RICO must be resolved in a federal judicial forum.

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[2] *Page* v. *Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 806 F.2d 291 (1st Cir. 1986); *Sevinor* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 807 F.2d 16 (1st Cir. 1986); *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), *cert. granted*, —— U.S. ——, 107 S. Ct. 60 (U.S. Oct. 6, 1986) (No. 86-44); *Tashea* v. *Bache, Halsey, Stuart, Shields, Inc.*, 802 F.2d 1337 (11th Cir. 1986).

I.

To the Extent the Question Is Not Resolved in *Shearson/American Express, Inc.* v. *McMahon*, No. 86-44, This Court Should Grant Certiorari to Determine Whether Congress Intended That RICO Claims Be Resolved Only in a Federal Judicial Forum.

A. *Congress Intended to Create an Exception to the United States Arbitration Act for Civil Claims Arising Under RICO.*

This Court has consistently held that the creation of a special statutory remedy by Congress renders a private agreement to arbitrate a federal statutory claim unenforceable. *See McDonald* v. *City of West Branch, Michigan*, 466 U.S. 284, 290-92 (1984) (Civil Rights Act of 1871); *Barrentine* v. *Arkansas-Best Freight System, Inc.*, 450 U.S. 728, 743-45 (1981) (Fair Labor Standards Act); *Alexander* v. *Gardner-Denver Co.*, 415 U.S. 36, 56-58 (1974) (Title VII of the Civil Rights Act of 1964); *Wilko* v. *Swan*, 346 U.S. 427, 438 (1953) (Securities Act of 1933).

Similarly, RICO's provision for an express private right of action clearly evinces that Congress intended that such claims be adjudicated only in a federal judicial forum. 18 U.S.C. § 1964(c). It is respectfully submitted that this conclusion is entirely consistent with this Court's recent decision in *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, —— U.S. ——, 105 S. Ct. 3346 (1985).

The principal issue before this Court in *Mitsubishi* was whether claims arising under the Sherman Act, 15 U.S.C. § 1, *et seq.*, in an international commercial transaction are arbitrable pursuant to Section 2 of the United States Arbitration Act, 9 U.S.C. § 2 (1982). In concluding that such claims are subject to the United States Arbitration Act, this Court stated:

> that concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties' agreement, *even assuming that a contrary result would be forthcoming in a domestic context.*

Mitsubishi, 105 S. Ct. at 3355 (emphasis added).

Similarly, in *Scherk* v. *Alberto-Culver Co.,* 417 U.S. 506 (1974), this Court ruled that claims arising under section 10(b) of the 1934 Exchange Act can be compelled to arbitration if the contractual provision arises from an international business transaction.

The common denominator in *Mitsubishi* and *Scherk* were the freely negotiated contracts which included forum-selection clauses to arbitrate disputes abroad. In *Mitsubishi,* the parties agreed that "[a]ll disputes, controversies or differences . . . shall be finally settled by arbitration in Japan in accordance with the rules and regulations of the Japan Commercial Arbitration Association." *Mitsubishi,* 105 S. Ct. at 3349. In *Scherk* the parties agreed that "any controversy or claim . . . would be referred to arbitration before the International Chamber of Commerce in Paris, France . . . ." *Scherk* v. *Alberto-Culver Co.,* 417 U.S. at 508.

Admittedly, in the international commercial arena, the method of resolving foreseeable disputes and the ability to agree on a neutral forum may impact not only upon salient contract terms, such as price, but also upon the overall acceptability of the transaction. *See Alberto-Culver Co.* v. *Scherk,* 484 F.2d 611, 617 (7th Cir. 1973) (Stevens, J., dissenting), *rev'd, Scherk* v. *Alberto-Culver Co.,* 417 U.S. 506 (1974). These concerns and those of international

comity and the congressional implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 9 U.S.C. § 201, *et seq.*, prompted this Court to compel Soler Chrysler-Plymouth and Alberto-Culver Company to arbitrate their disputes. This Court acknowledged, however, that a contrary result might be forthcoming in a case such as this one which presents a purely domestic dispute governed by federal law. *Mitsubishi,* 105 S. Ct. at 3355.

The fact that a civil RICO action is an express private right created by Congress is critical and must be accorded great deference. Indeed, the RICO statute has nearly the identical statutory characteristics that compelled this Court in *Wilko* v. *Swan* to rule claims arising under the 1933 Act nonarbitrable: the express private right of action, *compare* 18 U.S.C. § 1964(c) (1982) with 15 U.S.C. § 77*l* (1982); nationwide service of process and a wider choice of venue, *compare* 18 U.S.C. § 1965 (1982) with 15 U.S.C. § 77v (1982); and a "special right" to recover that differs substantially from the common law.[3] *Wilko* v. *Swan,* 346 U.S. at 431.

Moreover, this Court has acknowledged that arbitration cannot provide an adequate substitute for a judicial proceeding in protecting certain federal statutory rights. *Dean Witter Reynolds, Inc.* v. *Byrd,* 470 U.S. 213, 105 S. Ct. 1238, 1243 (1985). "The loss of the proper judicial forum carries with it the loss of substantial rights." *Scherk* v. *Alberto-Culver Co.,* 417 U.S. at 532 (Douglas, J., dissenting).

Although the 1933 Act contains a "non-waiver clause" which this Court has held prohibits arbitration of 1933

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[3] The text of these provisions is reproduced at Appendix A.

Act claims, *see* 15 U.S.C. § 77n (1982),[4] the absence of a non-waiver clause from the RICO statute does not preclude non-arbitrability in this particular instance. In a typical RICO scenario, a non-waiver clause would be unnecessary. Until this Court's recent interpretation of RICO's salient civil provisions in *Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479, 105 S. Ct. 3275 (1985), RICO's target in general was criminal activity, the adjudication of which is clearly not arbitrable.[5]

Moreover, Congress would not have anticipated that racketeers and their victims would agree in advance to arbitrate any disputes, thereby necessitating a precautionary non-waiver clause in the statute.

B. *The Quasi-criminal Nature of and Public Policy Considerations Inherent in Civil RICO Actions Mandate Adjudication by Article III Judges.*

This Court has acknowledged the quasi-criminal nature of the RICO statute, *see Sedima*, 105 S. Ct. at 3283, which mandates that petitioners pursue their express civil remedy only in a federal judicial forum. By definition, "racketeering activity" includes indictable federal offenses. 18 U.S.C. § 1961. Thus, the unlawful predicate acts underlying a RICO claim cannot lend themselves to arbitration. *Page* v. *Moseley, Hallgarten, Estabrook & Weeden*, 806 F.2d 291, 298-99 (1st Cir. 1986).

Moreover, the momentous public policy considerations at issue weigh heavily against the arbitrability of civil RICO claims. As stated by the Second Circuit in *McMahon*

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[4] The text of this provision is reproduced at Appendix A.

[5] In fact, with the exception of one section pertaining to the purchase of prison-made products by federal departments, *see* 18 U.S.C. § 4124 (1982), Title 18 of the United States Code entitled "Crimes and Criminal Procedure" does not contain a "non-waiver" clause or any other statutory provision pertaining to arbitration.

v. *Shearson/American Express, Inc.*, 788 F.2d 94 (2d Cir.), *cert. granted*, —— U.S. ——, 107 S. Ct. 60 (U.S. Oct. 6, 1986) (No. 86-44):

> Enforcement of the RICO statute is particularly appropriate in a judicial forum because of strong policy concerns, the need for development of the record, and judicial clarification and resulting consistency in resolving disputes under this relatively new statute.

788 F.2d at 98-99.

Allegations of fraud in connection with the sale of securities by national brokerage firms and their employees have a significant impact on society at large. More than fifty years ago Congress enacted the 1933 Act and the 1934 Exchange Act to protect the investing public by establishing higher standards of conduct in the securities industry. *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 389 (1983). Whereas a federal district judge must enforce legislative policy, an arbitrator has no such obligation. *See Alexander* v. *Gardner-Denver Co.*, 415 U.S. at 56-57. The special role of the arbitrator is only to effectuate the intent of the parties. *Id.* Thus, in rendering a decision, an arbitrator can legally ignore the legislative considerations which gave rise to legislation intended to protect the investing public.

In addition, because of the informality of arbitration, the rights and procedures common to civil trials, such as discovery, compulsory process and cross-examination, are often unavailable or severely limited. *Id.* at 57. Furthermore, since arbitrators are not obliged to articulate or record their reasons for an award, there would be no method of review or ensuring that Congress' "express admonition that RICO is to 'be liberally construed to effectuate its remedial purposes'" would be preserved. *Sedima*, 105 S. Ct. at 3286. The remedial purposes intended by

Congress are most evident by RICO's provision for an express private right of action for those injured by a pattern of racketeering activity. *Id.* at 3283 n.10 and 3286.

CONCLUSION

For all the foregoing reasons, petitioners respectfully request that (a) a writ of certiorari issue in this case to review the judgment of the United States Court of Appeals for the Fifth Circuit; (b) upon issuance of the writ of certiorari, that consideration of the judgment of the Fifth Circuit be withheld pending the issuance of this Court's decision in *Shearson/American Express, Inc.* v. *McMahon;* (c) this case be remanded to the Fifth Circuit for the entry of a judgment in accordance with *McMahon;* and (d) to the extent the arbitrability of civil RICO claims is not resolved in *McMahon,* that this Court resolve that issue in the instant case.

Dated: New York, New York
February 10, 1987

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APPENDICES

APPENDIX A

Statutory Provisions Involved

United States Arbitration Act

9 U.S.C. § 2:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Racketeer Influenced And Corrupt Organizations Act ("RICO")

18 U.S.C. § 1964:

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

18 U.S.C. § 1965:

(a) Any civil action or proceeding under this chapter against any person may be instituted in the district court of the United States for any district in which such person resides, is found, has an agent, or transacts his affairs.

(b) In any action under section 1964 of this chapter in any district court of the United States in which it is shown that the ends of justice require that other parties residing in any other district be brought before the court, the court may cause such parties to be summoned, and process for that purpose may be served in any judicial district of the United States by the marshal thereof.

(c) In any civil or criminal action or proceeding instituted by the United States under this chapter in the district court of the United States for any judicial district, subpoenas issued by such court to compel the attendance of witnesses may be served in any other judicial district, except that in any civil action or proceeding no such subpoena shall be issued for service upon any individual who resides in another district at a place more than one hundred miles from the place at which such court is held without approval given by a judge of such court upon a showing of good cause.

(d) All other process in any action or proceeding under this chapter may be served on any person in any judicial district in which such person resides, is found, has an agent, or transacts his affairs.

Securities Act of 1933

Section 12, 15 U.S.C. § 77*l*:

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section),

by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22, 15 U.S.C. § 77v:

(a) The district courts of the United States, and the United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and

Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found.

APPENDIX B

Opinion of United States Court of Appeals

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 86-1224

Summary Calendar

GILBERT R. RUSSELL and CRINCO INVESTMENTS, INC.,

Plaintiffs-Appellants,

versus

SHEARSON LEHMAN BROTHERS, INC., LEON P. BOMAR, III, and WAYLON MAX NIMMO,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

(Docket No. CA-3-85-2335-R)

(November 13, 1986)

Before CLARK, Chief Judge, REAVLEY and WILLIAMS, Circuit Judges.

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* Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that rule, the court has determined that this opinion should not be published.

Appendix B—Opinion of United States Court of Appeals

PER CURIAM:

Gilbert R. Russell and Crinco Investments, Inc. appeal from a district court order dismissing their claim under the 1933 Securities Act and compelling arbitration of their remaining claims. We affirm in part, reverse in part, vacate in part, and remand for further proceedings.

I.

From November 1982 through May 1984 Russell and Crinco each maintained separate securities accounts and commodities accounts at Shearson Lehman Brothers, Inc. Russell and Crinco filed suit in November 1985 alleging that from December 1983 through May 1984, Waylon Nimmo, account executive at Shearson, and Leon Bomar III, Shearson's branch manager, engaged in various actions to defraud Russell and Crinco. The suit alleged violations of the federal securities laws, the Racketeer Influenced and Corrupt Organizations Act (RICO), the Commodity Exchange Act, as well as various state law claims. Russell and Crinco sought recovery for losses of $1,948,433.03 sustained on their securities accounts with Shearson and losses of $2,054,093.74 sustained on their commodities accounts.

The defendants filed a motion to dismiss, to compel arbitration, and to stay proceedings pending arbitration. They contended that the plaintiffs' claim under the Securities Act of 1933 was barred by the statute of limitations and that Russell and Crinco had agreed to arbitrate all other claims. The district court granted the defendants' motion. It concluded that the 1933 Act claim should be dismissed because the statute of limitations clearly had run. The

district court then compelled arbitration of the other claims, including plaintiffs' claims under the Securities Exchange Act of 1934, RICO, and the Commodity Exchange Act. As no claims were then before it, the district court stayed its proceedings pending arbitration and quashed plaintiffs' discovery requests. Russell and Crinco appeal.[1]

II.

Russell and Crinco initially argue that the district court erred by dismissing their claim under the 1933 Securities Act as untimely. Section 13 of the 1933 Act provides:

> No action shall be maintained to enforce any liability created under section 77k or 771(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence. . . . In no event shall any such action be brought to enforce a liability created under section 77k or 771(2) of this title more than three years after the security was bona fide offered to the public. . . .

15 U.S.C. § 77m. Plaintiffs filed suit in November 1985, one year and six months after they incurred the final losses from defendants' alleged fraud. The action was timely under the three-year absolute bar contained in section 13. *Summer* v. *Land & Leisure, Inc.*, 664 F.2d 965, 968 (5th Cir. 1981) (Unit B), *cert. denied*, 458 U.S. 1106 (1982).

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[1] The district court also dismissed one of the plaintiffs' state law claims and compelled arbitration of the remaining claims. Russell and Crinco do not appeal from that portion of the district court's order.

But unless Russell and Crinco in the exercise of due diligence could not have discovered the alleged fraud until November 1984, six months after they suffered their final losses, their claim is barred by the one-year time limitation.

The district court dismissed plaintiffs' claims solely on the basis of the facts alleged in their complaint. A motion to dismiss for failure to state a claim should be granted only if "it appears to a certainty that the plaintiff would be entitled to no relief under any set of facts which could be proved in support of the claim." *R.A.G.S. Couture, Inc.* v. *Hyatt,* 774 F.2d 1350, 1353 (5th Cir. 1985); *Watts* v. *Graves,* 720 F.2d 1416, 1423 (5th Cir. 1983). The district court did not explain its conclusion that the 1933 Act claim was untimely. Apparently the court determined that it would not have taken a reasonable person six months to discover fraud after losing over $4 million in a short time.

Whether a plaintiff has exercised due diligence is a factual question that cannot readily be answered as a matter of law. *Aldrich* v. *McCulloch Properties, Inc.,* 627 F. 2d 1036, 1042 (10th Cir. 1980). As this court stated in *Azalea Meats, Inc.* v. *Muscat,* 386 F.2d 5, 9 (5th Cir. 1967) (footnote omitted):

> The concept of due diligence is not imprisoned within the frame of a rigid standard; it is protean in application. A fraud which is flagrant and widely publicized may require the defrauded party to make immediate inquiry. On the other hand, one artfully concealed or convincingly practiced upon its victim may justify much greater inactivity. The presence of a fiduciary relationship or evidence of fraudulent concealment bears heavily on the issue of due diligence.

Often the due diligence of the plaintiff is best determined at trial by the finder of fact. *See id.*

The complaint filed by Russell and Crinco does not establish when they discovered the fraud or what steps they took to determine the cause of their losses.[2] It does allege, however, that the defendants concealed sales of their shares, concealed losses resulting from excessive trading, intentionally withheld confirmations of transactions, intentionally withheld margin call notices, and intentionally misrepresented the equity of and positions in plaintiffs' securities accounts. The facts plaintiffs could prove in support of these allegations might establish their exercise of due diligence. We do not hold that a trial of the claim is required. Discovery or other procedures might make summary judgment appropriate. We say no more than that dismissal of the 1933 Act claim solely on the basis of plaintiff's complaint was improper.

III.

Russell and Crinco also raise several challenges to the portion of the district court's order finding their remaining claims arbitrable and staying the proceedings pending arbitration. First, both argue that the district court erred in compelling arbitration of their claims under the 1934 Securities Exchange Act and RICO. Recent decisions of this circuit have definitively settled both contentions, albeit with opposite results. We reaffirmed our rule that 1934 Act claims are nonarbitrable in *Bustamante* v. *Rotan Mosel, Inc.*, No. 86-2300, slip op. at 339, 340 (Oct. 17, 1986).

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[2] Although other courts might require plaintiffs to affirmatively plead those facts, *see, e.g., Hagert* v. *Glickman, Lurie, Eiger & Co.*, 520 F. Supp. 1028, 1033 (D. Minn. 1981), defendants have not challenged this aspect of the Russell and Crinco complaint.

The district court should not have compelled arbitration of the 1934 Act claim.[3] Under facts similar to those in the present case, a civil RICO claim has been held arbitrable. *Mayaja, Inc.* v. *Bodkin,* No. 85-2762, slip op. at 671, 686 (Oct. 24, 1986). The district court properly compelled arbitration of plaintiffs' RICO claim.

Second, Russell argues that the district court erred in compelling arbitration of his Commodity Exchange Act claim because Shearson never proved that he agreed to arbitrate that claim. Shearson responds by seeking to supplement the record on appeal with a copy of Russell's agreement to arbitrate claims arising out of his commodities account. Federal Rule of Appellate Procedure 10(e) provides that "[i]f anything material to either party is omitted from the record by error or accident . . . the court of appeals, on proper suggestion or of its own initiative, may direct that the omission . . . be corrected."

The arbitration agreement clearly is material to an issue on appeal. Shearson had no opportunity to correct the omission of Russell's agreement from the record on appeal. Russell first asserted the lack of an agreement to arbitrate in his opposition to Shearson's motion to compel arbitration. That same day, the district court compelled arbitration of the claim. Russell's discovery requests were quashed before Shearson had to respond. Russell does not challenge the validity of the arbitration agreement or deny making the agreement. Russell cannot claim to be surprised by the existence of a document that he does not deny signing. We grant Shearson's motion to supplement

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[3] Russell and Crinco also argue that agreements to arbitrate claims under the federal securities laws are void because they violate 17 C.F.R. § 240.15c2-2(a) (1986). Consideration of this argument is unnecessary.

the record on appeal. Based on the executed agreement, the district court properly compelled arbitration of Russell's Commodity Exchange Act claim.

Third, Russell and Crinco take issue with the stay of proceedings pending arbitration. Russell and Crinco seek to have us vacate the stay and remand the 1933 Act and 1934 Act claims for trial. The district court is the proper body to rule on whether the nonarbitrable claims should be stayed pending arbitration. *See Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1, 20 n.23 (1983). Because the district court stayed its proceedings on the assumptions that the 1933 Act claim was untimely and that the 1934 Act claim was arbitrable, we vacate the stay order as to those claims and remand to the district court to make those determinations in light of this opinion.

IV.

Finally, Russell and Crinco maintain that the district court erred in quashing their discovery requests. They contend that they should have been allowed discovery on the existence of Russell's agreement to arbitrate commodities claims. Because the record has been supplemented with that agreement, this contention is moot. They also contend that they should have been allowed discovery on the validity of their agreements to arbitrate federal securities laws claims. This contention has no merit. Those agreements are unenforceable as a matter of law. *See Bustamante,* slip op. at 340. The district court acted properly in quashing plaintiffs' discovery requests when all proceedings before it were stayed. This ruling is without prejudice to the right of Russell and Crinco to renew discovery requests on their 1933 Act or 1934 Act claims

should the district court not stay those proceedings pending arbitration.

The order appealed from is:

1) affirmed with respect to requiring arbitration of the claims under RICO and the Commodity Exchange Act;

2) reversed with respect to dismissal of the claim under the 1933 Securities Act;

3) reversed with respect to the requirement to arbitrate the claim under the 1934 Securities Exchange Act;

4) vacated with respect to the stay of proceedings as to the 1933 Act and 1934 Act claims.

The cause is remanded for further proceedings consistent with this opinion.

AFFIRMED in part,
REVERSED in part, and
VACATED in part.
REMANDED.

APPENDIX C

Order of United States District Court

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

CA3-85-2335-R

GILBERT R. RUSSELL and CRINCO INVESTMENTS, INC.,

VS.

SHEARSON LEHMAN BROTHERS, INC., et al.

ORDER

The defendants have moved to dismiss, compel arbitration, stay proceedings, and to quash and stay discovery. Their motion to dismiss is GRANTED in part and DENIED in part, and the motion to compel arbitration is GRANTED; the motion to quash and stay discovery is GRANTED.

Dismissal. Count I must be dismissed, as the one-year statute of limitations contained in 77 U.S.C. § 77m has clearly run. Count VI will not be dismissed. Count IX will be dismissed under *Swenson* v. *Englestad,* 626 F.2d 421, 428 (5th Cir. 1980) (holding that sales of securities are not covered by the DTPA). Counts II, III, IV, VII, X, and XI will not be dismissed under Rule 9.

Arbitration. All of plaintiffs' remaining claims will be arbitrated. *See Frye* v. *Paine Webber Jackson & Curtis,*

et al., No. CA3-83-1061-G (N.D. Tex. Dec. 26, 1985) (opinion attached).

Discovery. All discovery will be stayed pending outcome of the arbitration proceedings. Plaintiffs' discovery requests are therefore quashed.

Accordingly, the case is STAYED pending outcome of arbitration.

Signed this 10th day of March, 1986.

/s/ Jerry Buchmeyer

JERRY BUCHMEYER
United States District Judge

Appendix C (Continued)—Memorandum Order of United States District Court

IN THE

UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF TEXAS

DALLAS DIVISION

NANCY C. FRYE,

Plaintiff,

VS.

PAINE WEBBER JACKSON & CURTIS, et al.,

Defendants.

MEMORANDUM ORDER

This case is before the court on the motion of defendants Paine Webber Jackson & Curtis, et al. ("Paine Webber") to compel arbitration and to stay the litigation pending arbitration. For the reasons stated below, the court is of the opinion that the motion should be granted.

1. *Background*

Plaintiff Nancy C. Frye ("Frye") opened an account with Paine Webber on June 11, 1982, transferring into that account 12,212 shares of Commodore International, Ltd. Paine Webber employees Ken George ("George") and Dean McGowan ("McGowan"), defendants herein, allegedly recommended to Frye that she open an option account with Paine Webber, proposing an elaborate scheme to use the Commodore stock to generate income. George

and McGowan reportedly assured Frye that the recommended course of action would not jeopardize her ownership of the Commodore stock. Gary Bassett ("Bassett"), Frye's consultant, allegedly agreed with the proposed scheme. Due to alleged mismanagement, Frye lost most of her Commodore stock and, since the market value of the stock appreciated, allegedly was denied the opportunity to obtain profits in excess of $1,000,000.00.

Frye asserts claims under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), Rule 10b-5, 17 C.F.R. § 240.10b-5, and various provisions of the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* She also asserts pending state-law claims, including statutory and common law fraud, breach of contract, breach of fiduciary duties, and negligence.

The case was tried earlier this year before the Honorable William M. Taylor, Jr. On February 21, 1985, Judge Taylor granted Paine Webber's motion for directed verdict. The case then proceeded against a remaining defendant until, upon Frye's motion, Judge Taylor granted a mistrial. The case was subsequently transferred to the undersigned for further proceedings.

II. *The Arbitration Agreement*

Paragraph 15 of the agreement between Paine Webber and Frye provides for arbitration of certain controversies:

> Any controversy between us arising out of or relating to this contract or the breach thereof, shall be settled by arbitration, in accordance with the rules, then obtaining, of either the Arbitration Committee of the New York Stock Exchange, American Stock Exchange,

Appendix C (Continued)—Memorandum Order of United States District Court

> National Association of Securities Dealers or where appropriate, Chicago Board Option Exchange or Commodities Futures Trading Commission as I [Frye] may elect. I authorize you if I do not make such election, by registered mail addressed to you at your main office within fifteen (15) days after receipt of notification from you requesting such election, to make such election in my behalf. Any arbitration hereunder shall be before at least three arbitrators and the award of the arbitrators, or a majority of them, shall be final, and judgment upon the award rendered may be entered in any court, state or federal, having jurisdiction.

On April 3, 1985, counsel for Paine Webber sent a letter to Frye's counsel requesting arbitration. Neither Frye nor her counsel responded. On April 24, 1985, counsel for Paine Webber sent a letter to Frye's counsel selecting arbitration before the Arbitration Committee of the New York Stock Exchange.

Frye asserts that the arbitration paragraph does not mandate arbitration but merely provides an opportunity timely to elect arbitration. Neither party contests the applicability of the arbitration agreement to the securities claims if the court determines that they are arbitrable. Frye contends, however, that by willingly and actively participating in and seeking affirmative relief in judicial proceedings for over two years, Paine Webber has waived the right to seek arbitration of any disputes. Frye further asserts that even if the pendent state claims are found arbitrable, the claims arising under the securities acts are not arbitrable as a matter of federal law.

Appendix C (Continued)—Memorandum Order of United States District Court

III. *Analysis*

A. *The Arbitration Act*

9 U.S.C. § 2 provides for the validity and enforceability of arbitration agreements:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

The Arbitration Act evinces a strong national policy favoring arbitration whenever the parties opt for that method of dispute resolution. *Houston General Insurance Company* v. *Realex Group, N.V.*, 776 F.2d 514, 516 (5th Cir. 1985). In light of the federal policy favoring arbitration, any written agreement to submit a dispute to arbitration should be liberally construed, and any doubt as to arbitrability of an issue should be resolved in favor of arbitration. *Austin Municipal Securities, Inc.* v. *National Association of Securities Dealers, Inc.*, 757 F.2d 676, 696 (5th Cir. 1985). *See Mitsubishi Motors Corporation* v. *Soler Chrysler-Plymouth, Inc.*, —— U.S. ——, 105 S. Ct. 3346, 3353-54 (1985); *Southland Corporation* v. *Keating*, 465 U.S. 1, ——, 104 S. Ct. 852, 860 (1984); *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corporation*, 460 U.S. 1, 24, 103 S. Ct. 927, 941-42 (1983).

Appendix C (Continued)—Memorandum Order of United States District Court

B. *The Effect of Dean Witter Reynolds, Inc.* v. *Byrd*

In *Dean Witter Reynolds, Inc.* v. *Byrd*, —— U.S. ——, 105 S. Ct. 1238 (1985), the Supreme Court held that a court may not deny a motion to compel arbitration of state-law claims pursuant to an arbitration agreement when a complaint raises both federal securities and pendent state claims. The court further held that the section 2 directive is mandatory:

> By its terms, the [Federal Arbitration] Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed.

Id. at 1241 (emphasis in original). *See NPS Communications, Inc.* v. *Continental Group, Inc.*, 760 F.2d 463, 465 (2d Cir. 1985); *Austin Municipal Securities*, 757 F.2d at 697.

C. *Waiver*

Frye argues that Paine Webber has nevertheless waived any right it may have had to compel arbitration. The court does not agree. First, the burden of one seeking to prove waiver of arbitration is a heavy one. *Tenneco Resins, Inc.* v. *Davy International, AG*, 770 F.2d 416, 420 (5th Cir. 1985); *Sibley* v. *Tandy Corporation*, 543 F.2d 540, 542 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).

Second, the Supreme Court stated in *Moses Cone* that

> the Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction

> of the contract language itself or an allegation of *waiver, delay,* or a like defense to arbitrability.

Moses Cone, 460 U.S. at 24-25 (emphasis added).

Third, prior to the *Dean Witter* decision, a motion to compel arbitration would have been futile. Previously, the Fifth Circuit adhered to the doctrine of intertwining, *see* 105 S. Ct. at 1240, which dictated that if arbitrable and nonarbitrable claims were factually and legally inextricably intertwined, the federal court could retain jurisdiction over the entire case. *See, e.g., Commerce Park at DFW Freeport* v. *Mardian Construction Company,* 729 F.2d 334, 339 (5th Cir. 1984); *Smoky Greenhaw Cotton Co., Inc.* v. *Merrill Lynch, Pierce Fenner & Smith, Inc.,* 720 F.2d 1446, 1448 (5th Cir. 1983); *Miley* v. *Oppenheimer & Company, Inc.,* 637 F.2d 318, 334-37 (5th Cir. 1981). The court in *Dean Witter* expressly rejected the doctrine, *see* 105 S. Ct. at 1240-41, and held that the necessity of bifurcating proceedings did not eliminate arbitration as an alternative method of dispute resolution:

> The legislative history of the Act establishes that the purpose behind its passage was to ensure judicial enforcement of privately made agreements to arbitrate. We therefore reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims. The Act, after all, does not mandate the arbitration of all claims, but merely the enforcement—upon the motion of one of the parties—of privately negotiated arbitration agreements.

Id. at 1242.

Appendix C (Continued)—Memorandum Order of United States District Court

The *Dean Witter* opinion was issued March 4, 1985. Paine Webber requested arbitration on April 3, 1985. Since the decision, Paine Webber has not participated in discovery, amended its pleadings, or otherwise acted to suggest waiver of arbitration. Consequently, Frye had not carried its "heavy burden" of establishing that Paine Webber waived its right to arbitration.

D. *Securities Act of 1933*

Frye argues that, even if *Dean Witter* requires arbitration of the pendent claims, her securities claims, founded on laws evincing a unique legislative intent to regulate securities transactions uniformly, must be resolved in a judicial forum.

In *Wilko* v. *Swan,* 346 U.S. 427 (1953), the Supreme Court held invalid agreements to arbitrate claims arising under the 1933 Securities Act. The court based its decision on three interrelated provisions of the 1933 Act. Section 12(2), 15 U.S.C. § 77*l*(2), provides a "special right to recover for misrepresentation which differs substantially from the common law action," which requires a judicial forum to assure its effectiveness. Section 22, 15 U.S.C. § 77v(a), provides for state and federal jurisdiction, nationwide service of process, and a wide choice in venue in federal court. Finally, section 14, 15 U.S.C. § 77n, voids any "condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision" of the 1933 Act. 346 U.S. at 430-31.

The *Wilko* Court ruled that an agreement to arbitrate "is a 'stipulation,' and . . . [that] the right to select the judicial forum is the kind of 'provision' that cannot be waived under § 14 of the Securities Act [of 1933]." 346

U.S. at 434-35. Thus, the *Wilko* court resolved the conflict between the policy favoring arbitration and the policy underlying the 1933 Securities Act in favor of the 1933 Act:

> Two policies, not easily reconcilable, are involved in this case. Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment. On the other hand, it has enacted the Securities Act to protect the right of investors and has forbidden a waiver of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the [1933] Act.

Id. at 438.

In *Scherk* v. *Alberto-Culver Company,* 417 U.S. 506 (1974), the Supreme Court reaffirmed the validity of *Wilko* as to claims under the Securities Act of 1933 but declined to extend its reach to claims arising under the Securities Exchange Act of 1934. 417 U.S. at 511-15. The Fifth Circuit, on the other hand, has espoused the view that *Wilko* applies to claims under both statutes. *See, e.g., Sawyer* v. *Raymond James & Associates, Inc.,* 642 F.2d 791, 792 (5th Cir. 1981); *Sibley,* 543 F.2d at 543. Whichever reading of *Wilko* is correct, it is safe to say that at least any

of Frye's claims arising under the 1933 Act are not arbitrable.[1]

E. *Securities Exchange Act of 1934*

Although the plaintiffs in *Dean Witter* urged § 10(b) and Rule 10b-5 claims, the Supreme Court expressly declined to consider the arbitrability of these claims.[2] Nevertheless, some guidance as to the court's view of the arbitrability of statutory claims was provided in its later *Mitsubishi* decision. The court there held that an agreement to arbitrate antitrust claims should be enforced if the agreement arises from an international transaction. 105 S. Ct. at 3361.

Although the instant case does not involve an international transaction, the *Mitsubishi* court seemed receptive to arbitration of statutory claims, noting that "we find no warrant in the Arbitration Act for implying in every con-

[1] The court is unable to discern, however, exactly what claims Frye may be alleging under the 1933 Act. Although the joint pretrial order submitted February 8, 1985 asserts that jurisdiction and venue exist under the 1933 Act (page 1), Frye's claims (pp. 2-11) explicitly mention the 1933 Act only once, in the context of "controlling person" liability for Paine Webber (p. 10). Similarly, her memorandum in opposition to arbitration filed November 26, 1985 refers to claims under the 1933 Act (pp. 102) but discusses only claims under Rule 10b-5 of the 1934 Act (pp. 16-21). It thus appears that most, if not all, of Frye's federal securities claims arise under the Securities Exchange Act of 1934. The arbitrability of those claims is discussed below.

[2] "Dean Witter and *amici* representing the securities industry urge us to resolve the applicability of *Wilko* to claims under § 10(b) and Rule 10b-5. We decline to do so. In the District Court, Dean Witter did not seek to compel arbitration of the federal securities claims. Thus, the question whether *Wilko* applies to § 10(b) and Rule 10b-5 claims is not properly before us."

Dean Witter, 105 S. Ct. at 1240 n.1.

tract within its ken a presumption against arbitration of statutory claims." 105 S. Ct. at 3353. Section 2 and the Arbitration Act as a whole manifest "a policy guaranteeing the enforcement of private contractual arrangements." *Id.*

After cautioning that not all controversies implicating statutory rights were proper subjects for arbitration, the court noted that the critical determination was whether Congress' intention as to the substantive protection afforded by a given statute, deducible from the text or the legislative history, was to include protection against waiver of the right to a judicial forum. *Id.*

Justice White, concurring in *Dean Witter,* suggested that section 10(b) and Rule 10b-5 are arbitrable. He reasoned that jurisdiction under the 1934 Act, restricted to the federal courts, is narrower than under the 1933 Act. *See* 15 U.S.C. § 78aa; 15 U.S.C. § 77v. Furthermore, the cause of action under § 10(b) and Rule 10b-5 is implied rather than express and more like the common-law action. *See Herman & MacLean* v. *Huddleston,* 459 U.S. 375, 380 and nn.9-10 (1983). Thus, solicitude for the federal judicial cause of action is less appropriate. 105 S. Ct. 1244.

After a review of recent decisions on this subject, this court concludes that Congress has not evinced an intent to preclude arbitration of claims arising under the 1934 Act. *See, e.g., Osborne* v. *Shearson Lehman/American Express, Inc.,* No. CA 3-85-1340-F (N.D. Tex. October 1, 1985); *McMahon* v. *Shearson/American Express, Inc.,* CCH Fed. Sec. L. Rep. ¶ 92,319 (1985 Transfer Binder) (S.D.N.Y. 1985); *Finkle & Ross* v. *A.G. Becker Paribas, Inc.,* Nos. 85 Civ. 1858, 85 Civ. 2284 (S.D.N.Y. December 2, 1985); *McKinney* v. *Sutton,* C.A. No. C-85-15 (S.D. Tex. November 8, 1985); *Byrd* v. *Dean, Witter, Reynolds, Inc.,*

No. 82-1655-T (S.D. Calif. July 8, 1985); *Finn* v. *Davis*, No. 84-8414-Civ.-Gonzalez (S.D. Fla. June 19, 1985); *Coonly* v. *Rotan Mosle*, No. A-83-CA-529 (W.D. Tex. June 11, 1985).

Accordingly, the court concludes that Frye's section 10(b) and Rule 10b-5 claims are arbitrable.

IV. *Stay Pending Arbitration*

Section 3 of the Arbitration Act provides for a stay of proceedings when an issue therein is referable to arbitration:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3 (West 1970).

Frye asserts that the litigation should not be stayed because defendants McGowan and George were not parties to the arbitration agreement. Under the Arbitration Act, however, an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement. *Tenneco Resins, Inc.*, 770 F.2d at 422.

To control its docket, conserve judicial resources, and provide for a just determination of the case pending be-

fore it, *Moses H. Cone*, 103 S. Ct. at 939 n.23; *Contracting Northwest* v. *City of Fredericksburg*, 713 F.2d 382, 387 (8th Cir. 1983), a district court has inherent power to grant a stay of all proceedings pending arbitration. The Fifth Circuit rule is that "if some claims are arbitrable and others are not and they are easily severable . . ., the court should stay proceedings as to those claims which are arbitrable." *Coastal (Bermuda) Ltd.* v. *E.W. Saybolt & Co., Inc.*, 761 F.2d 198, 203 n.6 (5th Cir. 1985); *Wick* v. *Atlantic Marine, Inc.*, 605 F.2d 166, 168 (5th Cir. 1979); *Sibley* v. *Tandy Corporation*, 543 F.2d at 544.

The court concludes that the claims are not easily severable and that concurrent disposition would be inexpedient and judicially wasteful; consequently, the court orders a stay of all proceedings pending arbitration of the arbitrable issues.

V. *Conclusion*

For the reasons stated above, Paine Webber's motion to compel arbitration is GRANTED. All proceedings herein shall be stayed pending resolution of the arbitrable issues. The parties are directed to report to the court in writing the status of the arbitration within ten (10) days after a decision is made by the arbitrators or, in any event, by June 30, 1986.

So ORDERED.

December 26, 1985.

/s/ A. Joe Fish

A. JOE FISH
United States District Judge

APPENDIX D

Judgment of United States Court of Appeals

IN THE

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 86-1224

D.C. Docket No. CA-3-85-2335-R

GILBERT R. RUSSELL and CRINCO INVESTMENTS, INC.,

Plaintiffs-Appellants,

versus

SHEARSON LEHMAN BROTHERS, INC., LEON P. BOMAR, III, and WAYLON MAX NIMMO,

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Texas

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Before CLARK, Chief Judge, REAVLEY, and WILLIAMS, Circuit Judges.

JUDGMENT

This cause came on to be heard on the record on appeal and was taken under submission on the briefs on file.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the order of the District Court appealed from in this cause is affirmed in part and re-

versed in part, vacated in part, and the cause is remanded to the District Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that costs on appeal be taxed equally against the parties by the Clerk of this Court.

November 13, 1986

ISSUED AS MANDATE: Dec. 5, 1986

GILBERT F. GANUCHEAU
Clerk

/s/ H. E. Adams, Jr.

H. E. ADAMS, JR.
Deputy Clerk

No. 86-1340

In The

Supreme Court Of The United States

OCTOBER TERM, 1986

GILBERT R. RUSSELL AND
CRINCO INVESTMENTS, INC.,
Petitioners,

v.

SHEARSON LEHMAN BROTHERS INC.
F/K/A SHEARSON/LEHMAN AMERICAN
EXPRESS, INC., AND LEON BOMAR III,
Respondents.

RESPONDENTS' BRIEF ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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30 pp

QUESTION PRESENTED

Are federal district courts barred from enforcing agreements to arbitrate a claim arising out of a contractual relationship if the claim is based upon the Racketeer Influenced & Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* (1982) ("RICO")?

RULE 28.1 LIST

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Inc.

Active Subsidiaries

Boston Hambro Corp.
Boulevard Investors Inc.
Boulevard Real Estate Corp.
Burlington Investors Inc.
E.B. Realty
Lombard Realty Corporation
Lowell Investors Inc.
Lowell Real Estate Corp.
Shearson Dat-Cheong Company Limited
Shearson Lehman/Amex Finanz A.G.
Shearson/KM, Inc.
Shearson/NGP Inc.

Inactive Subsidiaries

Genex Insurance Brokerage Ltd.
Mideast-American, Inc.

Affiliates

Banque Euorfin
Barony Company Ltd.
California S.A.
Carnegie Capital Management Company
Shearson Financial Services of Oklahoma, Inc.
Shearson Financial Services of Texas, Inc.
Shearson Lehman Brothers SARL
Intermodal Equipment Associates
KCC Syndicate Managers, Inc.
McLeod Young Weir Limited
New World Corporation
Rex Moor Properties Incorporated
Russell Energy Inc.
Sovran Energy Corp.

Non-Wholly Owned Subsidiaries and Affiliates of Shearson Lehman Brothers Holdings Inc., the parent company of Shearson Lehman Brothers Inc.*

American Express Asset Management Limited
American Express Asset Management N.V.
American Express Asset Management S.A.
American Express U.K. Holding Company Inc.
Dr Pepper Holding Company
FGIC Corporation
Kuhn Leob Lehman Brothers International B.V.
Lehman Brothers International UK Ltd.
Lehman International Finance N.V.
Lehman Overseas N.V.
LBKL 82-1 Investors Inc.
Shearson Lehman Broadgate North Inc.
Shearson Lehman Broadgate South Inc.
Shearson Lehman Brothers Limited
The McLeod Young Weir Corporation

* The parent company of Shearson Lehman Brothers Holdings Inc. is the American Express Company.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES — (Continued)

TABLE OF AUTHORITIES — (Continued)

Cases Page

Statutes and Regulations

TABLE OF AUTHORITIES — (Continued)

Articles Page

Other Materials

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act, 9 U.S.C. § 1, *et seq.* (1970)

Section 2, 9 U.S.C. § 2

Section 3, 9 U.S.C. § 3

Racketeer Influenced & Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* (1982)

NO. 86-1340

In The

Supreme Court Of The United States

OCTOBER TERM, 1986

GILBERT R. RUSSELL AND
CRINCO INVESTMENTS, INC.,

Petitioners,

v.

SHEARSON LEHMAN BROTHERS INC.
F/K/A SHEARSON/LEHMAN AMERICAN
EXPRESS, INC., AND LEON BOMAR III,

Respondents.

RESPONDENTS' BRIEF ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Respondents Shearson Lehman Brothers Inc., ("Shearson") and Leon Bomar III, defendants below, respectfully pray that (a) a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, which affirmed in part, reversed in part, vacated in part and remanded an Order of the United States District Court for the Northern District of Texas; and (b) upon issuance of a writ of certiorari, consideration of the Fifth Circuit decision be withheld pending the issuance of the Court's opinion in *Shearson/American Express Inc. v. McMahon,* No. 86-44 (U.S. 1986) (*"McMahon"*); and (c) to

the extent the issue presented here is unresolved by *McMahon,* that this Court resolve that issue in this case.

The district court enforced a pre-existing agreement between Shearson and petitioners/plaintiffs, who were customers of Shearson, to arbitrate all disputes arising out of their customer-broker relationship. The district court ordered arbitration of petitioners' claims brought under § 1964(c) of the Racketeer Influenced & Corrupt Organizations Act, 18 U.S.C. § 1961, *et seq.* (1982) ("RICO").

On appeal, the Fifth Circuit upheld the district court in part and ruled that district courts within its jurisdiction must enforce agreements to arbitrate RICO claims, following its earlier decision in *Mayaja v. Bodkin,* 803 F.2d 157 (5th Cir. 1986).

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is unreported. That opinion is reproduced in Petitioners' Petition for Writ of Certiorari. The opinion of the United States District Court for the Northern District of Texas is also reproduced in the Petition.

JURISDICTION

The judgment of the Court of Appeals was entered on December 5, 1986. A copy of the judgment is reproduced in the Petition. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1) (1982).

STATEMENT OF THE CASE

During 1982 and 1983, petitioners maintained securities accounts and commodities accounts with Shearson. When they opened their accounts, petitioners signed Customer

Agreements with Shearson, each of which provided for arbitration of any controversy relating to the accounts. A typical agreement provided in part:

> Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules, then in effect, of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc., and/or the American Stock Exchange, Inc. as I [the customer] may elect.

Petitioners traded actively in their Shearson accounts through May 1984 and incurred substantial losses, of which losses Appellants were regularly advised by Shearson. On November 22, 1985, nineteen months after the last transactions in their Shearson accounts, Petitioners filed this lawsuit against Shearson, its Fort Worth branch manager Leon Bomar, and Shearson's broker Waylon Max Nimmo.

Respondents moved for an order compelling arbitration of petitioners' claims, and the district court granted respondents' motion on March 10, 1986. *See* Appendix C to Petition for Writ of Certiorari. Petitioners appealed that order to the Fifth Circuit. Stating that petitioners' case involved nothing more than "well-settled principles of law," the Fifth Circuit declined to hear oral argument and summarily affirmed the district court's order compelling arbitration of petitioners' RICO claims, relying on its earlier decision in *Mayaja v. Bodkin*, 803 F.2d 157 (5th Cir. 1986) (*"Mayaja"*). The Fifth Circuit also reversed the district court's order compelling arbitration of petitioners' 1933 Securities Act and 1934 Securities Exchange Act claims. *See* Appendix C to Petition for Writ of Certiorari. Petitioners have requested

that this Court grant a writ of certiorari to review the Fifth Circuit's decision compelling arbitration of their RICO claims.

REASONS FOR GRANTING THE WRIT

In compelling arbitration of petitioners' RICO claims below, the Fifth Circuit relied on its decision on *Mayaja.* Respondents believe that decision is correct, but that this Court should grant certiorari to resolve the conflict among the Circuit Courts of Appeal. The Fifth Circuit's decision in *Mayaja,* mandating enforcement of agreements to arbitrate claims under RICO, is in direct conflict with the decision of the Eleventh Circuit in *Tashea v. Bache, Halsey, Stuart, Shields, Inc.,* 802 F.2d 1337 (11th Cir. 1986), and the decision of the First Circuit in *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.,* 806 F.2d 291 (1st Cir. 1986), which decisions refused to enforce agreements to arbitrate RICO claims.

As a result of the conflict in the circuits, this Court granted certiorari in *McMahon* and heard oral argument on that case on March 3, 1987. If the Court does not resolve the conflict in the circuits on the arbitrability of RICO claims in *McMahon,* Shearson respectfully requests that the Court do so in this case.

The Fifth Circuit's decision to arbitrate RICO claims conforms with recent decisions of this Court and with the clear mandate of Congress in the Arbitration Act, that all doubts concerning the scope of arbitrable issues are to be resolved in favor of arbitration. However, until the arbitrability *vel non* of civil RICO claims is resolved, parties to arbitration agreements will continue to be deprived of an efficient, expeditious, and less expensive alternative to federal courts for settling their disputes. Meanwhile, each passing day will

clog the courts with more motions raising this issue, and with more lawsuits asserting claims that should be determined through arbitration.

I. To the Extent the Question Remains Unresolved After *McMahon*, This Court Should Grant Certiorari to Decide Whether Congress Intended to Prohibit the Enforcement of Agreements to Arbitrate RICO Claims.

Congress enacted RICO principally to combat the infiltration of legitimate business by organized crime. *United States v. Turkette*, 452 U.S. 576, 591 (1981). In the years since its passage, however, the private cause of action under RICO has been "evolving into something quite different from the original conception of its enactors." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, ____, 105 S. Ct. 3275, 3287 (1985). "Racketeering" is becoming a basic claim in commercial disputes; ordinary customer complaints about their securities brokers are now RICO claims.[1] As the Seventh Circuit has observed, Congress inadvertently "may well have created a runaway treble damage bonanza for the already excessively litigious." *Schacht v. Brown*, 711 F.2d 1343, 1361 (7th Cir.), *cert. denied*, 464 U.S. 1002 (1983).

After an extensive examination of RICO's legislative history, the Fifth Circuit correctly recognized that the principal thrust behind RICO's private treble damages provision was

[1] "RICO claims are now added as a matter of course in virtually all cases challenging securities transactions." American Institute of Certified Public Accountants, "The Authority to Bring Private Treble-Damage Suits Under 'RICO' Should Be Reformed," *AICPA White Paper On Civil RICO* at 2 (July 31, 1985), *reprinted in* Oversight on Civil RICO Suits: Hearings on Oversight on Civil RICO Suits Brought Under 18 U.S.C. 1964(c) Before the Senate Committee on the Judiciary, 99th Cong., 1st Sess. 251, 255 (1985) (hereinafter cited as *"AICPA White Paper"*).

compensatory, not punitive. *Mayaja*, 803 F.2d at 165. The Fifth Circuit found three currents of Congressional purpose impelling RICO's passage: first and foremost, the intent to compensate the victims of organized crime; second, to deter organized criminal activity; and third, to duplicate the remedies available under Section 4 of the Clayton Act. *Id.*

The Fifth Circuit went on to investigate the congressional purposes behind Section 4 of the Clayton Act, to determine their applicability to RICO's purposes. In doing so, the Fifth Circuit followed this Court's analysis in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 105 S. Ct. 3346 (1985) (*"Mitsubishi"*):

> The Supreme Court in *Mitsubishi* thoroughly examined the legislative intent behind section 4 of the Clayton Act for the purpose of determining the arbitrability of section 4 claims. 105 S. Ct. at 3358-60. While acknowledging that "[t]he treble-damages provision wielded by the private litigant is a chief tool in the antitrust enforcement scheme, posing a crucial deterrent to potential violators," *id.* at 3358, the Court held that "[n]otwithstanding its important incidental policing function, the treble-damages cause of action . . . seeks primarily to enable an injured competitor to gain compensation for that injury." *Id.* at 3359. Because the deterrent function was secondary to the compensatory function, the Court concluded that "so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Id.* at 3359-60.
>
> *Mitsubishi's* reading of the legislative purpose of section 4 of the Clayton Act, recurrently invoked during the congressional discussion of RICO's private treble-damages provision, accords with our analysis of the legislative history of section 1964(c). The primary purpose of the section is to compensate those injured by organized

> crime; the section's secondary purpose is to deter racketeers from inflicting such injuries. *Paralleling Mitsubishi's analysis, we find no evidence that Congress implied that all RICO claims be non-arbitrable. Since plaintiffs may effectively vindicate their section 1964(c) cause of action in the arbitral forum, the congressional purpose behind section 1964(c) will continue to be served.*

803 F.2d at 165 (emphasis supplied).

All circuit courts do not share the Fifth Circuit's view. *See, e.g., McMahon v. Shearson/American Express Inc.*, 788 F.2d 94 (2d Cir.) *cert. granted,* ____ U.S. ____, 107 S. Ct. 60 (No. 86-44) (1986); *Tashea v. Bache, Halsey, Stuart, Shields, Inc.*, 802 F.2d 1337 (11th Cir. 1986); and *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197 (3d Cir. 1986) (holding RICO claims predicated on mail and wire fraud statutes to be non-arbitrable).

Indeed, despite the Second, Third, and Eleventh Circuit Court's belief that the policies underlying RICO are too important to be left to arbitrators, the arbitration of civil RICO claims arising out of normal commercial relationships would have no effect on the types of claims RICO was meant to address: criminal actions, civil proceedings by the federal government pursuant to 18 U.S.C. § 1964(b), or lawsuits by private plaintiffs against mobsters attempting to

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[2] Unfortunately, as the New York Bar Association reported, "[c]ivil RICO has done literally nothing to advance Congress' goal of providing for 'an assault on organized crime and its economic roots.' This is hardly surprising: litigious through our society is, few would expect those injured in their businesses by the activities of 'the archetypal, intimidating mobster[s]' to serve summonses and complaints on such defendants." Committee on Federal Legislation, "Reform of the Private Civil Action Provision of RICO," 41 *The Record of the Association of the Bar of the City of New York* 412, 416 (May 1986) (footnotes omitted). Even rarer than a civil action against a member of organized crime would be a dispute between a mobster and a victim that was subject to an arbitration agreement.

infiltrate their business.[2] *See Ross v. Mathis*, 624 F. Supp. 110, 117 n.6 (N.D. Ga. 1985). Agreements such as the one at bar are struck at arms' length between parties to legitimate business transactions. There is no reason, either in public policy or Congressional intent, for district courts — rather than arbitrators — to be burdened with hearing these claims simply because a plaintiff has labelled them "racketeering."

The enforceability of agreements to arbitrate such claims is an open question, despite the lucidity and forcefulness of the Fifth Circuit's decision below. The strong trend of district court decisions since *Mitsubishi* was to direct arbitration of civil RICO claims.[3] However, since the Second, Third and Eleventh Circuits are now in conflict with the Fifth Circuit, District Courts will be rendering opinions inconsistent with one another. As the growing tide of RICO cases washes over the district courts, the conflict and confusion among the courts on this issue will only increase. In order to resolve this conflict at an early stage, this Court should grant certiorari to decide whatever questions remain concerning RICO's arbitrability after *McMahon*.

A. There Is a Conflict in the Circuit Courts As To the Arbitrability of RICO Claims.

This Court has never decided whether agreements to arbitrate civil RICO claims are enforceable. The Second, Third, and Eleventh Circuits have held that, to a greater or lesser extent, RICO claims are not arbitrable. The Fifth Circuit is the only circuit court of appeals to hold that *all* civil, commercial RICO claims are arbitrable. *Mayaja*, 803 F.2d at 166.

The issue has been intensely litigated in the district courts. At least 28 decisions have held that civil RICO

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[3] *See* Appendix F to Petition for Writ of Certiorari, *Shearson/American Express Inc. v. McMahon*, No. 86-44.

claims are arbitrable, while 19 decisions, many prior to *Mitsubishi,* have held that they are not. *See* Appendix F to Petition for Writ of Certiorari, *Shearson/American Express Inc. v. McMahon,* No. 86-44. In *Mitsubishi,* this Court corrected the mistaken assumption held by many district courts that antitrust claims could never be arbitrated. As this Court made clear, the dispositive question is whether Congress intended to exempt a particular claim from the requirements of the Arbitration Act. 105 S. Ct. at 3355.

Several of the district court decisions holding that RICO claims are not arbitrable were decided before *Mitsubishi,* and thus were based upon the assumption that antitrust claims could never be arbitrated. Analogizing RICO claims to antitrust claims, those courts concluded that RICO claims also could not be arbitrated.[4] The clear majority of the 39 district court cases deciding this issue since *Mitsubishi,* however, enforced agreements to arbitrate civil RICO claims. *See* Appendix F to Petition for Writ of Certiorari, *Shearson/American Express Inc. v. McMahon,* No. 86-44.

This Court's decision in *Mitsubishi* has had a compelling effect in the Fifth Circuit. The Fifth Circuit used *Mitsubishi* as its analytical framework for deciding *Mayaja:*

> In order for a statutory claim to overcome the overriding federal policy in favor of arbitration, *Moses H. Cone,* 460 U.S. at 24-25, it is necessary that the party

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[4] The antitrust analogy formed the basis for the leading pre-*Mitsubishi* decision regarding civil RICO arbitrability. *See S.A. Mineracao da Trindade-Samitri v. Utah Int'l Inc.,* 576 F. Supp. 566, 575 (S.D.N.Y. 1983), *order certified for interlocutory appeal,* 595 F. Supp. 1049 (S.D.N.Y.), *appealed on other grounds and affirmed,* 745 F.2d 190 (2d Cir. 1984). Other pre-*Mitsubishi* decisions adopted the reasoning of that decision. *See Ross v. Paine, Webber, Jackson & Curtis, Inc.,* No. C84-2311A (N.D. Ga. Mar. 29, 1985); *Witt v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 602 F. Supp. 867, 870 (W.D. Pa. 1985); *Wilcox v. Ho-Wing Sit,* 586 F. Supp. 561, 567 (N.D. Cal. 1984); *Universal Marine Ins. Co. v. Beacon Ins. Co.,* 588 F. Supp. 735, 738 (W.D.N.C. 1984).

opposing the motion to compel produce evidence that Congress intended the statutory claim to be non-arbitrable. *See Mitsubishi,* 105 S. Ct. at 3355. A mere absence of evidence that Congress intended the claims to be arbitrated is insufficient to overcome the presumption in favor of arbitrability; the party opposing the motion must show that Congress intended to make an exception to the Arbitration Act of the statutory claim in question. As the Supreme Court instructed in its *Mitsubishi* opinion:

> Just as it is the congressional policy manifested in the federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by the Act, it is the congressional intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable .... We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deducible from text or legislative history.

Id. Thus, the task of a court in determining the arbitrability of a claim under the Federal Arbitration Act is, first, to examine the relevant statutory text and legislative history for express evidence that Congress intended the statutory claim concerned to be non-arbitrable. In many cases Congress may not have explicitly addressed the arbitrability question. In this event, the court must carefully examine the *congressional* policies promoting the enactment of the cause of action to determine whether, in light of these policies, an implicit congressional intention that the claims under the statute not be subjected to arbitration may be inferred due to the inability of these policies to be furthered if the claims are subject to arbitration.

Mayaja, 803 F.2d at 161 (citations omitted, emphasis in original).

The importance to the federal judiciary of enforcing the congressional policies behind agreements to arbitrate civil RICO claims is demonstrated by the growing number of such claims being brought in the federal courts. As this Court has noted, the number of civil RICO actions has risen dramatically each year since the statute's passage. *Sedima*, 473 U.S. at ____ & n.1, 105 S. Ct. at 3277-78 & n.1.[5] According to the Administrative Office of the United States Courts, which compiles the annual Judicial Workload Statistics, a total of 474 civil RICO cases were filed in the district courts between December 1, 1985 and April 30, 1986.[6] As litigants become more comfortable with charging "racketeering" in commercial disputes, the number of RICO claims will only increase. Each day that goes by ensures that more courts will be required to adjudicate commercial disputes that — under any other name but RICO — would be submitted to an arbitrator.

There is a direct conflict between the Fifth, Second, Third, and Eleventh Circuits over this issue. The confusion and conflict concerning the enforceability of agreements to arbitrate civil RICO claims should be resolved by this Court before the increasing volume of such claims threatens to overwhelm our court system. *See Dawson Chemical Co. v. Rohm & Haas Co.*, 448 U.S. 176, 185 (1980) (certiorari granted to forestall a possible conflict in the lower courts on an important issue); *Massachusetts Trustees v. United States*, 377 U.S. 235, 237 (1964) ("a considerable number of

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[5] As the Court noted in *Sedima*, 473 U.S. at ____, 105 S. Ct. at 3277 n.1., according to the Report of the Ad Hoc Civil RICO Task Force, A.B.A. Section of Corp., Banking & Bus. Law at 55 (1985) (hereinafter cited as *"ABA Report"*), of the approximately 270 civil RICO trial court decisions between passage of the statute in 1970 and the end of 1984, 3% of the decisions were rendered in the decade of the 1970's and 43% in 1984.

[6] Communication from Elizabeth McGrath, Chief, Judicial Information Branch, Statistical Analysis and Reports Division, Administrative Office of the United States courts, Washington, D.C., dated June 27, 1986.

suits are pending in the lower courts which will turn on resolution of these issues"); *Comm'r v. Bilder*, 369 U.S. 499, 501 (1962) (citing "need for a uniform rule"); *see also New York v. Saper*, 336 U.S. 328, 329 (1949); *Shapiro v. United States*, 335 U.S. 1, 4 (1948).

B. The Fifth Circuit's Decision In This Case Is In Harmony With Congressional Intent, But the Conflict Among the Circuits Will Needlessly Burden the Courts and Litigants Unless the Fifth Circuit's Decision Is Reviewed and Affirmed.

The Fifth Circuit correctly analyzed Congressional intent in its decision. However, because other circuits do not adhere to this view, this Court should grant certiorari to resolve the conflict among the circuits.

1. The Fifth Circuit correctly held that there is no evidence that Congress intended to create an exception to the Arbitration Act for all civil RICO claims.

This Court stated in *Mitsubishi* that the strong national policy favoring arbitration requires the enforcement of agreements to arbitrate statutory claims unless Congress has expressed an intent to the contrary. *Mitsubishi*, 473 U.S. at ____, 105 S. Ct. at 3355.[7] The Fifth Circuit recognized and

[7] Indeed, with respect to rights expressly created by statute, such a rule is mandated by principles of statutory construction. "The cardinal rule is that repeals by implication are not favored." *Posadas v. Nat. City Bank*, 296 U.S. 497, 503 (1936); *see United States v. Will*, 449 U.S. 200, 221 (1980). Absent a clear and manifest expression of intention by the legislature to repeal its prior enactment, a subsequent statute will be construed as consistent with a prior statue, *See Posadas*, 296 U.S. at 503; *see also Randall v. Loftsgaarden*, ____ U.S. ____, 106 S. Ct. 3143 (1986); *Washington v. Miller*, 235 U.S. 422, 428 (1914). Because it contains no clear expression of Congressional intention to create an exception to the Arbitration Act, the RICO statute, enacted in 1979, should be construed as consistent with the Arbitration Act, in force since 1925.

applied that mandate in this case. Nothing in the language of the RICO statute, whether as originally enacted or subsequently amended, either explicitly or implicitly prohibits the arbitration of private RICO claims.[8] *Mayaja*, 803 F.2d at 164. Nor is there anything in the legislative history of RICO suggesting a Congressional intent to bar parties from agreeing to arbitrate RICO claims. *Mayaja*, 803 F.2d at 164-166. *Bob Ladd, Inc. v. Adcock*, 633 F. Supp. 241, 243-44 (E.D. Ark. 1986); *Bale v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650, 654 (D. Minn. 1986); *Sacks v. Dean Witter Reynolds, Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,429 at 92,642 (C.D. Cal. Dec. 31, 1985); *Brener v. Becker Paribas Inc.*, 628 F. Supp. 442, 449-50 (S.D.N.Y. 1985).

Unlike the Fifth Circuit's decision below, the Second Circuit's decision in *McMahon* contains no analysis of RICO's language or the statute's legislative history. Indeed, the Second Circuit did not even conclude that Congress, in enacting RICO, intended to carve out an exception to the Arbitration Act. The Second Circuit ignored *Mitsubishi*'s mandate and chose instead to create a judicial exception to the Arbitration Act, concluding that undefined "public policy" considerations barred arbitration of RICO claims. *McMahon*, 788 F.2d at 98-99. In so doing, the Second Circuit relied upon its own decision in *American Safety Equip. Corp. v. J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), in which it held

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[8] Many of the courts that have held private RICO claims arbitrable, including the Fifth Circuit, have based their decisions, in whole or in part, upon the absence of a non-waiver provision in the RICO statute. *See Mayaja*, 803 F.2d at 164; *Bale v. Dean Witter Reynolds, Inc.*, 627 F. Supp. 650, 654 (D. Minn. 1986); *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶92,276 at 91,899 (W.D. Pa. Apr. 19, 1985), *rev'd*, 797 F.2d 1197 (3d Cir. 1986); *Ross v. Mathis*, 624 F. Supp. at 116-17 & n.6; *Brener v. Becker Paribas Inc.*, 628 F. Supp. 442, 450 (S.D.N.Y. 1985).

that "the pervasive public interest in enforcement of the antitrust laws and the nature of the claims that arise in such cases, combine to make . . . antitrust claims . . . inappropriate for arbitration." *Id* at 827-28.[9]

In reyling upon *American Safety,* the Second Circuit in *McMahon* completely ignored *Mitsubishi:* if Congress did not find public policy concerns sufficiently persuasive to create an exception to the Arbitration Act for the particular claim in question, then the Arbitration Act's strong public policy considerations must control. Indeed, the *Mitsubishi* Court expressed skepticism over the validity of *American Safety* in any setting. *See Mitsubishi,* 473 U.S. at ____, 105 S. Ct. at 3355-60.

The Fifth Circuit, however, followed *Mitsubishi's* prescription. As the Fifth Circuit stated in *Mayaja:*

> *McMahon* ignores *Mitsubishi*'s instruction that congressional intent governs the analysis of arbitrability of a statutory claim under the Arbitration Act. After *Mitsubishi,* "determining statutory claims to be non-arbitrable on the basis of some judicially recognized public policy rather than as a matter of statutory interpretation is no longer permissible." [*Jacobson v. Merrill Lynch,* 797 F.2d at 1202]. Since *McMahon* does not base its decision on a statutory interpretation of section 1964(c), we cannot follow its analysis. Moreover, we find *McMahon*'s reliance on *American Safety* misplaced. Although the Supreme Court did not explicitly overrule *American Safety* in the domestic context, *Mitsubishi* rejected so much of *American Safety*'s reasoning

[9] To the extent that the Second Circuit's decision in *McMahon* and decisions from other circuits are based upon the belief that arbitrators are unable to decide issues of fraud and complicated commercial disputes competently and fairly, those decisions ignore the long experience of the securities industry in arbitrating the very types of claims that are asserted in RICO complaints. *See* C. Katsoris, *The Arbitration of a Public Securities Dispute,* 53 Fordham L. Rev. 279 (1984).

> it is difficult to say what is left of the opinion to rely on. *See Mitsubishi,* 105 S. Ct. at 3357-60. Certainly the Court rejected that portion of *American Safety*'s reasoning relied upon by *McMahon. See id.* at 3359 ("Notwithstanding its important incidental policing function, . . . § 4 of the Clayton Act . . . seeks primarily to enable an injured competitor to gain compensation for that injury.").

Mayaja, 803 F.2d at 163, n.6. Any reliance upon *American Safety*'s obvious distrust of arbitration, rather than on an analysis of Congressional intent, requires reversal.

2. Civil RICO claims rarely implicate public policy because they almost always involve simple commercial disputes.

Even assuming the continuing vitality of *American Safety,* that case's rationale is irrelevant to the arbitrability of most civil RICO claims. The vast majority of these claims do not involve public policy any more than do state law claims of fraud, which may be arbitrated. *See Dean Witter Reynolds Inc. v. Byrd,* 470 U.S. 213, 217 (1985). The district courts have come to recognize that "[t]he majority of civil RICO claims today do not impact on the general society or involve vital national interests . . ." *Bale,* 627 F. Supp. at 654. Commercial disputes that otherwise would involve only claims of breach of contract, securities law violations, or fraud are now framed as RICO claims. *Haroco, Inc. v. American Nat. Bank and Trust Co.,* 747 F.2d 384, 386-87 (7th Cir. 1984), *aff'd,* 473 U.S. 606 (1985) (per curiam); *see also The Supreme Court — Leading Cases,* 99 Harv. L. Rev. 120, 312-13 (1985) (the subject matter of private civil RICO actions in increasingly "'ordinary' commercial fraud").

This lawsuit is typical of the RICO action today. Petitioners' complaint alleges fraud based upon broker misrepresentations in their accounts; the "racketeering" activity in

petitioners' RICO claims is nothing more than the alleged misrepresentations that form the basis for the fraud claims. This is a classic example of plaintiffs' "Pavlovian inclusion of a RICO claim" in almost every securities lawsuit. *Huss v. Goldman, Sachs & Co.*, 635 F. Supp. 1227, 1228 (N.D. Ill. 1986). As the *Huss* Court noted, plaintiffs in securities cases "not only [assert] the standard claims under the 1933 and 1934 federal acts coupled of course with a state blue-sky law claim, but they now invariably also invoke [RICO]." 635 F. Supp. at 1227.

This type of "racketeering" claim is the rule, rather than the exception. RICO has become "essentially a federal business tort statute." *Bale*, 627 F. Supp. at 654, *see Bob Ladd, Inc.*, 633 F. Supp at 244 n.1., *Brener v. Becker Paribas Inc.*, 628 F. Supp. at 450; *West v. Drexel Burnham Lambert, Inc.*, 623 F. Supp. 26, 28-29 (W.D. Wash. 1985). A survey of trial court decisions conducted by the American Bar Association showed that 77% of all civil RICO cases reported involved securities fraud or mail or wire fraud in a commercial setting. *ABA Report* at 55-56. In that same survey, the ABA looked at 270 RICO lawsuits and discovered that broker-dealers were the primary defendants in at least 40 of the cases, banks were the primary defendants in 32 cases, and lawyers and accountants were defendants in 20 cases. *ABA Report* at 35 n.41. Another survey of 132 decisions in civil RICO cases indicated that 63 cases arose out of securities transactions or commodities trading, and other 38 cases arose out of commercial or contractual disputes. *AICPA White Paper* at 14-15.[10]

[10] RICO is currently, and very frequently, being utilized for purposes far afield from those envisioned by Congress. Not only has civil RICO been used against securities broker-dealers, commodities traders, investment bankers, commercial banks, financing institutions, insurance companies, manufacturing concerns, accounting firms and attorneys, *see ABA Report* at 35 & n.41, it has also been used outside the commercial world.

Many district courts with first-hand experience of RICO claims have concluded that such disputes can be resolved by arbitrators with no risk to public policy concerns. *See e.g., Steinberg v. The Illinois Co.*, 635 F. Supp. 615 (N.D. Ill. 1986); *Sacks*, Fed. Sec. L. Rep. ¶ 92,429 at 92,642; *see also West*, 623 F. Supp. at 29 ("there is no reason to pay lip service to a policy that justifies only a tiny minority of RICO cases").

Indeed, it is highly unlikely that the enforceability of arbitration agreements will ever arise in the types of cases that RICO was meant to address. A "contract" between "a shopkeeper [who] is approached by an organized crime henchman for protection money ... undoubtedly would not contain an agreement to arbitrate." *Ross v. Mathis*, 624 F. Supp. at 117 n.6.[11] There is thus no reason to hold that the public policy underlying RICO prevents civil RICO claims from being arbitrated. The Fifth Circuit's decision should be reviewed and affirmed as the rule for all federal courts.

See, e.g., Martin-Trigona v. D'Amato & Lynch, 559 F. Supp. 533 (S.D.N.Y. 1983) (legal assistance provided to *pro se* defendants in another action); *Pit Pros, Inc. v. Wolf*, 554 F. Supp. 284 (N.D. Ill. 1983) (landlord-tenant dispute); *Erlbaum v. Erlbaum* [1982] Fed. Sec. L. Rep. (CCH) ¶98,772 (E.D. Pa. July 13, 1982) (marital squabble); *Congregation Beth Yitzhok v. Briskman*, 566 F. Supp. 555 (E.D.N.Y. 1983) (religious dispute over control of congregation property); *King v. Lasher*, 572 F. Supp. 1377 (S.D.N.Y. 1983) (will contest).

[11] It is unlikely that claims involving the type of activity Congress intended RICO to address would be arbitrated for the additional reason that, under the Uniform Code of Arbitration, securities regulatory organizations have the right to decline the use of their arbitration facilities where the dispute "is not a proper subject matter for arbitration." Uniform Code of Arbitration § 1(b), N.A.S.D. Manual (CCH) § 3712(b). If this Court reversed the Second Circuit's *per se* rule, the lower courts could fashion a rule, such as the court applied in *West v. Drexel Burnham Lambert, Inc.*, 623 F. Supp. at 29, that the policy of enforcing arbitration agreements should prevail if the RICO claim "touches upon no great societal or public interest."

CONCLUSION

For the foregoing reasons, Respondents respectfully request that (a) this Court issue a writ of certiorari in this case to review the decision of the United States Court of Appeals for the Fifth Circuit, (b) consideration of the Fifth Circuit decision be withheld pending the Court's decision in *McMahon,* and (c) to the extent the arbitrability of RICO claims is not resolved in *McMahon,* that the Court resolve that issue in the present case.

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CERTIFICATE OF SERVICE

This will certify that three true and correct copies of the foregoing Respondents' Brief on Petition For Writ of Certiorari have been sent, by certified mail return receipt requested, to counsel of record for petitioners, James A. Flynn, Lambos, Flynn, Nyland & Giardino, 29 Broadway, 9th Floor, New York, New York 10006.